United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

ORIGINAL

74-1157

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WILLIAM R. VAN GEMERT, *et al.*,

Plaintiffs-Appellants,

against

THE BOEING COMPANY,

Defendant-Respondent.

On Appeal from the United States District Court for the Southern District of New York

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REPLY BRIEF FOR PLAINTIFFS-APPELLANTS

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REPLYING TO BOEING'S POINT II

A. Boeing's Brief Avoids the Fact That While Boeing Selected the "Barter-Equation" Method, It Did Not Follow It

In the absence of a better way, such as appraisal, it is recognized that a corporation may take the market price of the stock which it gives in exchange for assets as the measure of the value of the acquired assets. The Trial Court and Boeing call this the "barter-equation" method and we shall use that term.

Boeing elected to use the "barter-equation" method in acquiring the Vertol assets. Simple arithmetic shows that when

the results of the equation as applied by Boeing were unsatisfactory for Boeing's purposes, Boeing did not abide by those results. Boeing gave 448,544 of its shares in exchange for the Vertol assets. Boeing chose to take the market price of November 13, 1959 which was 33 5/8 a share. 448,954 x 33 5/8 = $15,096,078. Boeing says it equals $15,250,000. There is no way in contemporary arithmetic to make it equal $15,250,000.

The arithmetic does not deter Boeing from saying (at p. 29):

> "At this meeting [April 4, 1960] it was determined that the 'fair value' of the consideration paid to Vertol was to be determined on the basis of the market value of the 448,954 shares of Boeing capital stock on November 13, 1959 ($15,250,000), plus the $644,514 to be received upon the exercise of Vertol stock options, for a total of $15,894,514 (ASOF #77 at 184a)".

The $15,250,000 figure is a fiction.

That Boeing well knew in 1960 what it was doing appears on A.E. 28. "Alternative (4)" multiplies the asset plus the option shares (a total of 472,736) by 33 5/8 despite the provisions of Indenture Section 4.05(b)(v) which require options at less than $50 a share to be valued at the time the option is granted at the exercise price. That price was $27.10 (an aggregate of $644,514 for 23,782 shares). The Court will note that at the left of Alternative (4) on A.E. 28 Boeing did multiply only the asset shares by 33 5/8 and of course, determined that at 33 5/8 "448,954 = 15,096,078."

As appears in A.S. 81, Mr. Haynes added his own twist. Since with all of the shares at 33 5/8 he could accomplish his purpose but with only 27.10 for the option shares he could not, he first multiplied all of the shares by 33 5/8 reaching $15,895,748, of

which $799,669.75 were for the option shares. Then he subtracted the option price of $644,514, leaving an excess of $155,155.75 to be used for the asset shares. This excess of $155,000 added to the $15,096,078 he rounded off to $15,250,000.

The following(taken from Column (4) of the tables after p. 35 of our main brief) shows that assuming that Boeing was right on the stock dividends and on the November 13, 1959 date, a change was still required:

Source	Consideration
Indenture Valuation at July 1, 1958	$351,872,350
Boeing Present Contention 1958 Stock Dividend	16,012,417
Boeing Present Contention 1959 Stock Dividend	4,479,979
Boeing's Price- 33 5/8 on November 13, 1959 - for 448,954 Vertol asset shares	15,096,078
Agreed Price for Vertol Option Shares	644,514
	$388,105,338
Total shares outstanding x $100 =	$793,920,900
$793,920,900 ÷ $388,105,338 =	2.0456

Thus, even on this basis, the rate (to be computed to the nearest hundredth) should have become 2.05 on March 31, 1960. With a correct treatment of the dividends and a pricing of Boeing shares on March 31, 1960 rather than on November 13, 1959 the rate should have been 2.08.

Boeing did not apply the "barter-equation" method.

When it needed $155,000 it simply took it. Thus, its method was the "barter-equation" plus.

On July 15, 1958, Boeing borrowed $30,597,600 at 4 1/2% from individuals who accepted a lower interest rate in return for conversion rights which they were assured would not be diluted (cf. the 5% paid simultaneously on $40,000,000 of straight debt, A.E. 15, p. 4). In less than two years, on March 31, 1960, with all of the facts in its private possession, Boeing was willing to indulge in this tactic to deprive the holders of .08 of a share for each $100. Below 2.00 it could not go.*

B. The "Barter-Equation" Method Requires Selection of a Proper Pricing Date

At page 34, Boeing states:

> "Plaintiffs do not challenge the District Court's approval of the 'barter-equation' method of valuation used by Boeing's Board, i.e., valuing Vertol on the basis of the value of Boeing capital stock which Boeing was prepared to exchange for Vertol assets."

This, again, is error. We do not challenge the "barter-equation" method. We challenge pricing the stock as of the date on which "Boeing was prepared to exchange". The value of the method is in the objective way in which it works. When the parties are irrevocably bound or when they close, the method is meaningful. For a corporation to select a date when it "was prepared" to exchange opens the

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* Actually, until maturity or prior call, the increase would have been only .05. Interim increases were to be made only at intervals of .05.

door to chicanery. It is, therefore, inherent in the method, as Mr. Pivar testified, that the parties had "reached agreement" (App. p. 610a).

The status of the Vertol deal on November 13, 1959 is set forth in detail at pp. 15-17 of our main brief. Eight of thirteen Board members agreed on that date to make a counter-offer to Vertol but as late as November 16, 1959 no "firm decision to proceed" had been reached even <u>on the Boeing side</u> (A.E. 22, p. 7).

Mr. Allen testified that he did not know whether Boeing's counter-offer which could not have been made to Vertol before November 16th "would kill the deal or not" (App. p. 426a). Had Boeing the right to pick even November 16th if we assume that the counter-offer was delivered to Vertol as early as that?

It happened that the deal was, after further lengthy negotiations, consummated on the 2 for 3 basis. But let us suppose that Boeing stock had gone down thereafter and it had accepted the Vertol demand of 2.10 for 3. Or suppose Vertol stock had gone down and Vertol had accepted 1.5 for 3. Would Boeing have had the right, nevertheless, to value Vertol assets at 2 for 3 because it was "prepared" on November 13, 1959 to make that exchange? Boeing submits no authority to justify that date.

On the other hand, Mr. Pivar testified that November 13, 1959 was not acceptable:

"I would not consider the November 13th, 1959 date appropriate for making the determination because the parties had not reached agreement ** that date would not have any significance to me, or at least, not enough significance to warrant the use of the price on that date for valuation of the shares issued (App. 609a-610a)".

We respectfully submit that November 13, 1959 was not an acceptable date. Even a Board which had no adverse interest had no power to disregard logic and to disregard accepted objective standards because it was given the duty of determining value. In the face of Vertol's own book value of $12,435,000; in the face of profits which had steadily deteriorated into losses; in the face of current stock market prices which were even lower than the book value; for a Board with a conflict of interests to be deemed empowered to select a date which suited its purposes and which, when accompanied by other abuses, deprived the debentureholders of the fair value of their investment is unconscionable.

The date to be utilized in the "barter-equation" method for reasons which we gave in our main brief at pp. 44-7 should be March 31, 1960; or, if there is a valid alternative, perhaps January 18, 1960.

C. There Was No Substantial Performance And the Doctrine is Inapplicable In Any Event

The Court below (App. p. 312a) and Boeing (p. 36) fall back finally on "substantial performance." We do not know the full magnitude of the breach because debentures of the face amount of approximately $10,000,000 were converted before 1966

at prices which are not in the record. For the approximately $21,500,000 outstanding on March 8, 1966, the difference between 2.00 shares and 2.08 shares involved approximately $3,150,000. Boeing suggests at p. 36 that whether the breach was large or small should not be measured by those figures but only by the damage to plaintiffs. We do not agree for the breach affected those who did convert as well as those who did not. But the difference of $225,000 to holders of $1,500,000 of bonds (i.e. the plaintiffs) is not trivial either.

Obviously, the doctrine of "substantial performance" is far afield. In nearly every case of "substantial performance" A has built a structure for B and B refuses to pay because of a trivial failure by A to follow plans and specifications. In that situation, the burden is on A to show the amount of the damage he has caused to B and if he is able to do that A may recover the contract price less an allowance for the damage so demonstrated.

Spence v. Ham, 163 N.Y. 220 (1900)

On March 8, 1960, Boeing had not substantially performed its contract. It had paid interest on money which it had used. So far as the holders of two-thirds of the debentures were concerned, it had done nothing more. As to one-third of the holders it had given fewer shares on conversion than they were entitled to receive; the extent of their loss in dollars we do not know. Nor do we know what damage plaintiffs and others suffered; for how much they might have sold their debentures at any time between 1960 and 1966 if the published

conversion rate had been higher; or if they had elected to convert at the higher rate how much more they would have received for their stock. And, perhaps most important, plaintiffs had no obligation to perform. They did not promise to exercise their option and Boeing was not seeking to compel performance. It is only when the builder sues for breach of the owner's promise to pay that whether the builder has substantially performed becomes relevant.

Thus, there is no resemblance to the "substantial performance" cases.

If Boeing's offer to pay the principal or to convert at 2.00 - we presume that it did that in its letters to registered holders — were regarded as a tender of performance, the tender would constitute no defense against a failure by the owner to act because failure to tender the full number of shares due would render the tender a nullity.

Equitable Life Ins. Co. v. Von Blahn
107 N.Y. 637 (1887)

15 Williston on Contracts (3rd ed., 1972)
Section 1810, pp. 420-1

D. The Stock Dividend Matter Has Been Fully Covered

At pp 9-13 of our main brief we discussed the facts and at pp 47-51 the law with respect to the stock dividends. Boeing's brief produces no argument which we did not consider there.

We repeat that the stock dividends should have been

valued for purposes of the Indenture precisely as they were valued on Boeing's books and in accordance with common sense.

On November 4, 1958, the stock closed at 56 7/8. The dividend was 4%. This made the dividend shares worth 56 7/8 ÷ 1.04. That equals 54.69 or, as Boeing rounded it off on its records, 54.75. Everybody knows that when a pie is divided into 104 equal pieces each piece is smaller than if the same pie had been divided into 100 equal pieces. To say that the indenture provided that each dividend share had a value equal to that of the pre-dividend share is again to say that the Indenture was intended to be unfair rather than fair; or, to put it differently, that the anti-dilution clauses were intended to dilute rather than to prevent dilution of the conversion rights. The same applies to the 1959 stock dividend.

This is just one more way in which the debenture-holders were abused.

E. The Fact Remains that Boeing's Breach Precludes its Termination of Plaintiffs' Rights

Boeing's performance was necessarily a condition precedent to the exercise of plaintiffs' option. No debenture-holder could elect intelligently whether to hold, sell or convert without referring to the conversion rate. The Indenture imposed on Boeing the obligations to calculate the rate correctly and to publish the notice so that every holder and every potential buyer could hold, sell, convert or buy with knowledge of the facts.

Without publishing the correct rate Boeing had no "right to immediate performance" on its giving notice of a call for redemption as "the right to enforce the contract does not come into existence" until Boeing's obligation is "fulfilled."

3A Corbin on Contracts 16 (1960)

5 Williston on Contracts, op. cit., 126

REPLYING TO BOEING'S POINT I

A. The Debenture is a Contract of Adhesion

Boeing would have it that a contract of adhesion does not exist in take-it-or-leave-it contracts which are "not a necessity of life" (p. 17). If Boeing's position had any foundation, surely it could have cited one decision or one *dictum* or one writer's opinion in support of that proposition.

We have not found, in our own research, one word to distinguish contracts for "a necessity of life" from any other form contract. As we showed at p. 64 of our brief, Boeing was sued by an employee for failing to honor its contract in an employee suggestion contest. The Court called attention to the fact that this was a contract of adhesion. We must believe that such a contest is not a "necessity of life". It cannot have been a "necessity of life" to sell tomatoes to Campbell or to rent a filling station from Standard Oil. And we have no proof that buying an automobile on the instalment plan or that joining a Government agricultural plan was a "necessity of life" or that buying life or accident insurance

from a vending machine was the only way to buy the insurance. (See our main brief, pp. 64-7).

The Courts and the text and law review writers have agreed that the point is that one cannot apply to take-it-or-leave-it printed form contracts the rules of interpretation which are applied to bargained contracts; the latter must be presumed to contain language desired by both sides; the former just the opposite.

It has been said that even in contracts of adhesion the "expected coverage" can be defeated if the clause which denies that coverage is "plainly brought to the attention of the insured."

Steven v. Fidelity & Casualty Co., 58 Cal. 2d 862, 377 P. 2d 284 (1962)

Boeing wrote two letters to the stockholders and Boeing registered and distributed a prospectus (A.E.s 5, 15). In none of these did it bring the risk to the readers' attention and in none of them did it even mention the right to exchange the debenture for a registered one. At least the purchaser of a car on instalments sees what he is signing; the purchaser of flight insurance receives his policy while he is still at the machine; the renter of a filling station has a lease to sign.

These plaintiffs received the debentures after they had bought and paid for them. And even the debenture referred the reader to the Indenture for the terms of the notice and

registration provisions.

At least 93% of the debentures were never registered (A.S. 57, 58). It is hard to believe that if the right to register had been "plainly brought to the attention" of the holders only 7% would have registered.

B. The Cases Supporting Boeing

Boeing cites two District Court cases supporting its position on the published notice.

From the opinions in the two cases we believe that the courts were not informed that the names and addresses of the holders could be obtained with a minimum of trouble from the coupon deposit envelopes or from lists in the hands of the Trustee.

The doctrine of contracts of adhesion is that the acceptor is entitled to his reasonable expectations. If the Courts believe that personal notice is not feasible, they must hold that publication is a reasonable way.

We brought to the attention of the Court here 1) that Boeing could have obtained through Chase, its paying agent, the name and address of every depositor of coupons due January 1, 1966; 2) that Boeing had the names and addresses of the warrantholders who had bought at least 97% of the debentures and Boeing knew that its small stockholders were major purchasers of the debentures; and 3) that Boeing had no reason not to wait until shortly after July 1, 1966 to reach those who

deposited the July 1 coupons.

What is reasonable depends on the circumstances. At a nominal cost, Boeing could have prevented very large forfeitures. The history of the conversion rate and of Boeing's internal communications makes us believe that it preferred not to locate the holders.

With the opportunities to communicate shown in this record, publication did not meet the reasonable expectations of anyone.

C. The Provisions of the Trust Indenture Act

Boeing says (pp 23-4) that the Trial Court properly rejected our claim of violation of the Trust Indenture Act because "it was stipulated that BOEING had no names to furnish to Chase".

The Indenture provision is clear (A.E. 4, p. 58). It is not limited to information in Boeing's hands but requires that the trustee be given and that it retain a "list" of the names and addresses of holders known to Boeing and "its paying agents". In this case, Chase was both trustee and paying agent. It should have had a list. Boeing should have used that list.

Chase had records of the names and addresses of every individual and every bank which deposited the January 1, 1966 coupons (A.S. 53). Letters to those parties would have provided notice to most, if not all, of the plaintiffs.

COMMENTS ON THE CREDIBILITY OF WITNESSES AND THE TRIAL COURT'S ATTITUDE

The Kass brief (pp. 61-7) brings out the hostile attitude of the Trial Court. On the other hand, Boeing constantly stresses that the Trial Court's views on the credibility of witnesses must be respected. For these reasons we shall allude to the point made in the Kass brief which we had preferred previously not to mention.

The Kass brief says that "the Court turned the plaintiffs' examination into a farce" (p. 63). We believe that the reference is to cross-examination of Messrs. Haynes and Olsen. We regret to say that we must endorse this strong language.

Messrs. Haynes and Olsen were Boeing's principal witnesses. Mr. Haynes was the architect of the abuse of the conversion rate. Yet, Mr. Winer was not permitted to cross-examine him; Mr. Wechsler had to do so even though he had told the Court that he was "not capable of making an opening statement or examining witnesses" on the conversion issue (App. 322a).

Since Messrs. Haynes and Olsen were "cross-examined" by questions being whispered to Mr. Wechsler by Mr. Winer or written out by Mr. Winer and repeated by Mr. Wechsler to the witness, the credibility of Boeing's chief witnesses was simply not tested by cross-examination.

Boeing had two other witnesses. One was Mr. Allen,

a gentleman in his seventies, Chairman Emeritus of Boeing, who had read all of the memoranda and minutes and whose testimony was a repetition of those papers. Beyond the memoranda his lack of memory was hard to believe.

For example, Mr. Allen had no recollection of the existence of the 5% senior debenture issue of $40,000,000 which was sold simultaneously with the debentures (App. pp. 392a-393a). He was asked specifically whether Boeing had sold a senior issue of non-convertibles at the same time that it sold the debentures and he said "No". (App. p. 392a, Ls 20-22). He was asked a second time and he answered

> "No, that [the debentures] is the only issue I am familiar with in the '50s" (App. p. 392a, Lines 24-5 – p. 393a Ls 2-3).

At the same meeting in which Boeing resolved to issue the debentures it resolved to issue 5% straight debentures in the sum of $60,000,000, twice the size of the debentures (A.E. 2, p. 11); that issue was to be $60,000,000 as late as July 10, 1958 (A.E. 10, p. 4); it was reduced to $40,000,000, still one-third larger than the debentures, on or before July 15, 1958 (A.E. 13, p. 4, A.E. 15, p. 4); it remained outstanding without sinking fund reduction until 1964 (A.E. 36, p. 29) and until 1966 it was Boeing's only outstanding bond issue other than the debentures (A.E. 49). Beginning with 1964 it was being reduced by a sinking fund. As of December 31, 1972 (Mr. Allen testified in November, 1972) it was again the only outstanding Boeing bond issue. (Boeing's 1972 Annual Report).

Yet, Mr. Allen had no recollection of the issue. How

much credibility can be attached to his recitation of the contents of the memoranda?

As for the fourth Boeing witness, Mr. Gorans, we are content to rely on his cross-examination.

An example of a different sort to show the Court's approach to the case appears in the opinion. At App. p. 310a, the Court states:

> "Plaintiffs admit that the formula provided for in the Indenture had as its purpose the prevention of dilution of stock to the detriment of BOEING stockholders". (Emphasis supplied).

From this, the Court concluded that it was the Board's "duty and right to compute stock in such a way as to prevent its dilution."

To the best of our knowledge, nobody has ever suggested before that anti-dilution clauses in convertible issues were or are for the protection of the stockholders.

Let us quote Mr. Haynes (A.E. 26, first page which is numbered 5):

> "Mr. Haynes stated that in order to protect the holders of the Convertible Subordinated Debentures against dilution of the value of the convertible features of the Debentures upon the issuance of additional shares of capital stock of the company after the date of the Indenture, the Indenture provides that if any shares of stock are issued for a consideration less than $50 a share, an adjustment in the conversion rate may be required." (Emphasis supplied).

The prospectus states:

"The Indenture contains provisions to protect the conversion rate against dilution by making appropriate adjustments therein upon the occurrence of certain events ..." (Emphasis supplied, A.E. 15, p. 18).

If the Court thought that the purpose of the anti-dilution clause was to protect the stockholders from dilution of their stock, then his leanings in interpretation of the Indenture are more understandable. But, by the same token, the findings of the Court, based on such misapprehensions, should carry little weight.

C O N C L U S I O N

Boeing, in its brief, makes no effort to defend its valuing the option shares at the market price of November 13, 1959 rather than at the exercise price as required by Section 4.05(b)(v). It does not even deign to mention the matter. Its other breaches are also clear. But, as we showed at pp. 50-1 of our main brief, if Boeing's calculation was wrong in any one of three respects an increase in the conversion rate was required by the Indenture. A breach of the covenant to calculate the conversion rate properly was a prior breach of the very covenant which had to be performed if plaintiffs were to exercise their rights. Being in breach, Boeing could not impose on plaintiffs a condition of taking fewer shares than they were entitled to get or lose their conversion rights.

We respectfully submit that the evidence shows that Boeing was wilful and not in good faith with respect to the

conversion rate.

We respectfully submit also that in view of the several ways available to Boeing to reach the debentureholders, it was unreasonable and unconscionable for it to fail to notify the holders by mail and that it was indefensible for Boeing to attempt to deprive the holders of the conversion rights for which they had paid.

Plaintiffs pray for judgment in the sum of $5,846,102.08 plus interest from March 29, 1966. This represents 2.08 shares at $182 a share on each $100 debenture; the total face amount being $1,544,300. Boeing offers redemption at $1,594,489.75 without interest. The difference is $4,251,612.33 plus interest. Boeing is entitled to credit for sums which it paid after March 29, 1966 to those plaintiffs who did submit their bonds for redemption. Such plaintiffs did not lose their rights to recover damages for Boeing paid them only what was admittedly due.

Respectfully submitted,

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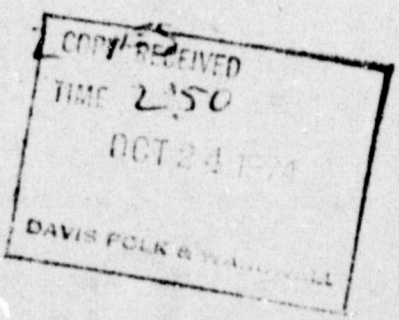

DATED 24th Oct , 1974

Yours, etc.
Plaintiff's Attorneys